EPRC ECONOMIC POLICY RESEARCH CENTRE

Towards Sustainable Development

The Uganda Business Climate Index

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An increase in the price of goods and services affects business operations

Executive summary

The Business Climate Index (BCI) remained below full potential for the ninth consecutive quarter since the first quarter of 2020. Business perceptions in the current quarter (January-March 2022) declined slightly by 6 basis points from 86 in the previous quarter (October-December 2021) to 80 in the current quarter (January-March 2022). The decline in business sentiments was primarily driven by a slight decline in capacity utilisation, increased product costs, salary, and a decline in the general business environment. On a sector basis, there was a decline in the condition for doing business in the manufacturing and agriculture sector and a slight improvement in the services sector.

Meanwhile, business sentiment for the next quarter (April–June 2021) remains optimistic and is expected to increase by 19 basis points to 99 from the current quarter index. The expected improvement is largely driven by improved capacity utilisation, reduced input costs and product prices, increased optimism, a more favourable average salary, and an improved business environment.

Nine in every ten the businesses surveyed reported a decline in the demand for their goods and services because of the hike in the prices. This has disrupted business operations, with businesses reporting insufficient demand to be more of a problem in the current quarter under review. There is a need for demand-driven policies to match the supply levels.

Data and methods

The data used in computing the Business Climate Index (BCI) is a panel of businesses based on the Uganda Bureau of Statistics Census of Business Establishment 2011, first tracked in 2012. This current quarter bulletin covered 175 business establishments. The panel element has enabled us to track the business environment in Uganda over time.

The BCI is computed based on the following business evaluation indicators: level of business activity, turnover, profitability, incoming new business, capacity utilisation, average costs of inputs, price of produced goods, business optimism, number of employees, and average monthly salary. For each of the evaluation indicators, respondents are asked to express their perceptions on a Likert scale as follows: "improved", "did not change", "declined" or "above normal for the quarter", "normal for the quarter", below average for the quarter" or "more favourable", "unchanged", "less favourable". These responses are coded as 0, 1, and 2, respectively. In this case, if a respondent's perception of the business environment is that it deteriorated, we would code such a response 0, it would be coded 1 if the business climate did not change and 2 if the business climate improved.

The index does not consider the magnitude of change in the data but considers the general direction of movement in the key indicators. As such, the index is sensitive to the direction as opposed to the magnitude of the change in business conditions. During the data collection process, we ask business managers to assess the general economic environment for the current quarter relative to the previous quarter; and their expectations for the next quarter. Based on the business evaluation indicators explained earlier, we compute the business climate index as the weighted arithmetic mean of indices of the individual business evaluation indicators. The indices range from 0 – 200. Interpreting the BCI is such that scores above 100, point to an improving business climate. Scores below 100, imply that the general business conditions are getting worse. And, a score of 100 points to unchanged business conditions.

Also, the index analyses the evolution of challenges facing businesses during January-March quarter 2022 by identifying which business constraints became more of a problem and less of a problem. We also ask business managers to indicate how each identified business constraint has evolved during the quarter. For each of the business constraints, we asked if it was "more of a problem", "unchanged", or "less of a problem". The resultant weighted indices range from -100 to 100, with positive scores suggesting that they perceive a particular constraint to be more of a problem in the current quarter; negative scores imply that a constraint is less of a problem, and zero scores point to business constraint whose severity has remained unchanged.

Results

Business Climate slightly declines, but the future sentiment remains optimistic.

Results indicate a decline in the conditions for doing business in the current quarter (January – March 2022) when compared to the previous quarter (October – December 2021) (Figure 1). The current quarter's business climate index is 80 and has slightly declined by 6 index points on a quarter-on-quarter basis, from 86 in the previous quarter (October–December 2021). For the ninth quarter in a row, the condition for doing business remained below full potential.

The slight decline in the conditions for doing business in Uganda during the period under review results from a general deterioration in all sub-indices, namely, business activity, profits, turnover, business environment and startup of new businesses, among others remaining below full potential (below 100). Just like the previous quarter (October –December 2021), the economy is still operating at less than full potential, a trend that has persisted for nine consecutive quarters.

The below potential performance in the business environment was primarily driven by the increase in the prices of essential goods and services, resulting in a high cost of doing business among producers and lower purchasing power among consumers. Notably, the high transport costs caused by high fuel prices, driven mainly by international fuel prices, have increased operating costs. A study by Odokonyero and Bulime (2022) concluded that there was a two dollar pass-through effect on the pump price for every dollar increase in global fuel prices. [1]

In addition, the increase in prices of some goods such as laundry bar soap, prices of cooking oil, and services such as education services has caused discomfort among the producers and consumers.

Indeed, the Uganda Bureau of Statistics[1] reported a 0.5 percentage point increment in consumer price index (CPI) to 3.2 percent for February 2022 from the previous 2.7 percent in January 2022. The increment in CPI was mainly due to increasing cooking oil, laundry bar soap and fuel prices. In the past year, there has been a 77.6 percent rise in the price of cooking oil, a 47.8 percent rise in the price of laundry bar soap and a 15.3 percent rise in the price of fuel. Notably, the increment was highest between December 2021 and February 2022, during which cooking oil prices increased by 21 percent, Laundry bar soap prices increased by 20 percent, and fuel prices increased by 15.3 percent, respectively. In the survey, they mainly attributed the rise in these prices to; i) the COVID-19 restrictions in some economies that are still disrupting the supply chain, ii) the reopening of most of the economies, which have led to excess demand, and iii) the Russia-Ukraine conflict, which has further disrupted the supply of cooking oil and cereals, for example, wheat, corn and sunflower oil.

Furthermore, the survey suggests that unfavourable tax policy, unfavourable macroeconomic factors, increased difficulty in accessing reliable and cheap electricity, competition from substandard products and corruption and bribery were the leading binding constraints to business competitiveness and were reported to be more of a problem in the current quarter under review.

The business climate index by sector

Conditions for doing business in all the three sectors (agriculture, manufacturing and services) are below full potential compared to the previous quarter ended December 2021. Business perceptions in the agriculture and manufacturing sector declined, whereas there was a slight improvement in the perception of doing business in the services sector (Figure 2). The agriculture sector faced the highest decline in conditions for doing business. Its' index declined by 41 index points from 97 registered in the previous quarter to 56 points. Similarly, the manufacturing sector also experienced a decline of 23 index points from 120 registered during the last quarter to 97 points in the current quarter. Notably, there was a slight improvement of 2 index points in the conditions for doing business among those in the services sector from 82 to 84 percent in the current quarter.

The decline in conditions for doing business in the agriculture sector was mainly due to increased pessimism within the business community, a reduction in the level of new business opportunities and a decline in capacity utilisation. Similarly, business sentiments in the manufacturing sector declined during the current quarter compared to the previous quarter because of a drop in the level of incoming new businesses, a reduction in capacity utilisation and an increase in the average employee salary compared to the previous quarter. On the other hand, the slight improvement in conditions for doing business in the services sector was mainly because of an increase in the level of business activity, increased optimism, an increase in the level of business profits, and an increase in the number of incoming new businesses.

1 https://www.finance.go.ug/sites/default/files/press/PRESS%20STATEMENT%200N%20THE%20RISING%20PRICES%200F%20ESSENTIAL%20COMMODITIES.pdf

Figure 1 The Business Climate Assessment

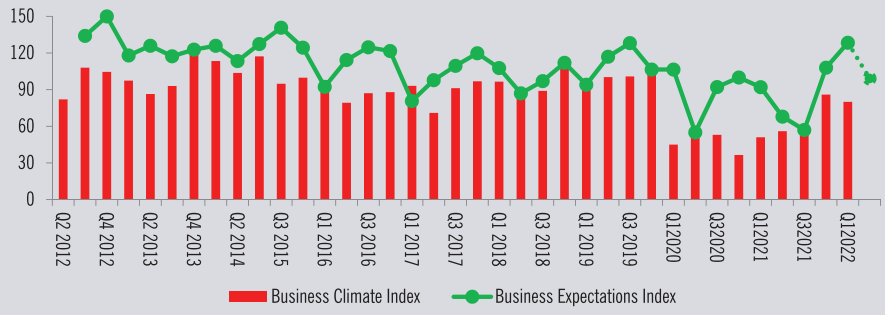


Figure 2 Business Climate Index by Sector

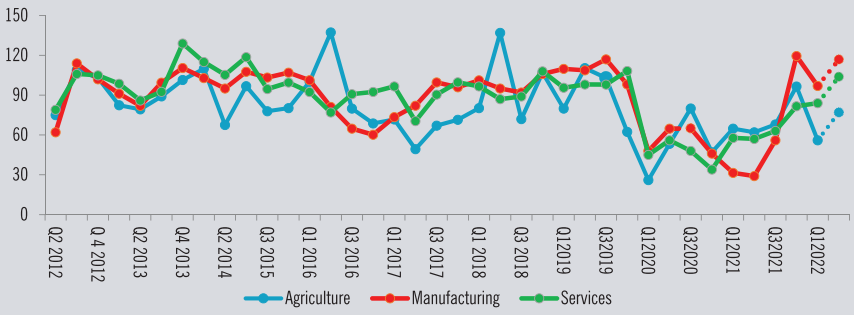
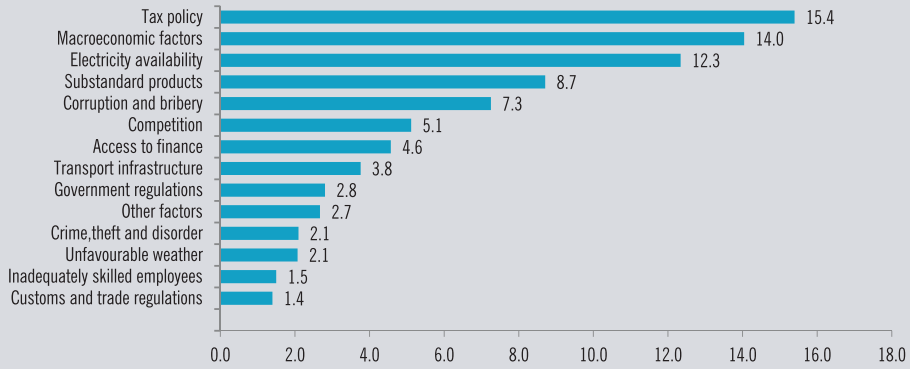


Figure 3 Business Constraints (%)



Enterprises also attributed the decline in conditions for doing business in the manufacturing sector to the decrease in the price of some commodities in February[2] and March[3]. Specifically, there was a deflation of 4.5 percent and 4.4 percent, in prices of food and non-alcoholic beverages in February and March 2022, respectively.

Challenges in doing business

The top five most binding constraints to doing business for the current quarter as reported by businesses comprised increased tax policy (15.4 percent), tighter macroeconomic policy (14.0 percent), inadequately available cheap and reliable electricity (12.3 percent), competition from substandard products (8.7), and corruption & bribery (7.3 percent).

Compared to the previous quarter, tax policy, macroeconomic policy, and corruption and bribery are still significant challenges facing Ugandan businesses. This suggests that major policy and regulatory constraints facing Ugandan businesses are persistent.

The reporting of a tighter tax policy by businesses could be attributed to the high costs of doing business (for example, the high transportation costs) amidst declining demand (increase in prices of some goods and services). This has resulted in reduced profit margins and a decline in the capacity of businesses to meet their tax obligations.

The macroeconomic factors reported are attributed mainly to the high exchange rate volatility. During the current quarter, the shilling further depreciated against the US dollar by UGX 43.8 from UGX 3,544 per dollar at the end of December 2021 to UGX 3,588 at the end of March 2022.[4] This reduces the purchasing power parity of domestic businesses, thus increasing trade costs.

Furthermore, access to electricity is still a challenge to the business community despite the Electricity Regulatory Authority's (ERA) reducing electricity tariffs for both commercial and domestic consumption. The reduction came in the third and fourth quarters of 2021.[5] This suggests that the declines have not relieved businesses from the high costs of electricity.

The evolution of business constraints

Similar to the previous quarter (October-December 2021), Tax policy, Macroeconomic factors, and insufficient demand were still considered the major challenges in doing business in the current quarter (Figure 4). This indicates the persistence of some of these challenges from the previous quarter. In addition, firms reported competition from substandard products to be more of a problem in the current quarter.

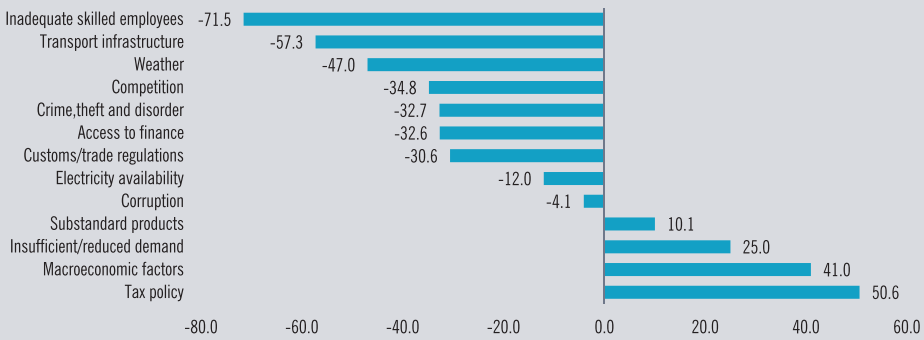
The decline in demand can be directly attributed to the increase in the inflation rate, resulting from the general increment in price levels of essential goods and services. This has consequently led to a decline in purchasing power and reduced demand. Indeed, the BOU[6] statistics indicate that the headline inflation increased by 0.7 percentage points from 2.5 percent in the previous quarter to 3.2 percent in the quarter under review. Similarly, core inflation increased by 0.5 percentage points from 2.5 percent during the last quarter to 3.0 percent. The prices of commodities such as cooking oil, laundry bar soap, fuel, and education services have increased.

As earlier mentioned, the persistence of macroeconomic factors and tax policy as challenges to doing business in the current quarter are because of an increase in the exchange rate, and the high cost of doing business that has reduced profits and the capability of businesses to meet their tax obligations, respectively.

Future business outlook: April – June 2022

Businesses continue to be optimistic about the near term developments. The expected index for April – June 2022 is 99 (Figure 1) and is 19 index points higher than the current quarter's index of 80 points, though below full potential. Generally, favorable business conditions are expected to come from an expected improvement in the business environment, more optimism, reduced production costs, reduced input costs and increased

Figure 4 The evolution of business constraints (% of businesses)



capital utilisation during the next quarter.

There are expected improvements in conditions for doing business in all sectors. However, sectoral differences are expected to prevail. In this regard, business confidence in the manufacturing and services sector are expected to be above normal, while conditions in the agriculture sector are anticipated to remain below normal. Despite these below normal expectations in the agriculture sector, the sector is expected to experience the most remarkable improvement of 21 index points from 56 in the current quarter to 77 in the next quarter (Figure 2). Firms expect the condition for doing business in manufacturing to increase by 20 index points from 97 in the current quarter to 117 in the next quarter. Similarly, the services sector is also expected to increase by 20 index points from 84 in the current quarter to 104 in the next quarter.

The anticipated slightly favourable sentiments for doing business in the agriculture sector are attributable to the anticipated improvement in capital utilisation, business environment, salary, and reduced labour costs. In the manufacturing sector, the anticipated improvement in conditions for doing business is linked to improvement in the business environment, optimism, reduced production costs, reduced input costs, and a more fair average salary expense. Similarly, the improvement in the business environment, increased optimism, reduced production costs, reduced input costs, and increased capital utilisation are the drivers of the expected improvement in conditions for doing business in the services sector.

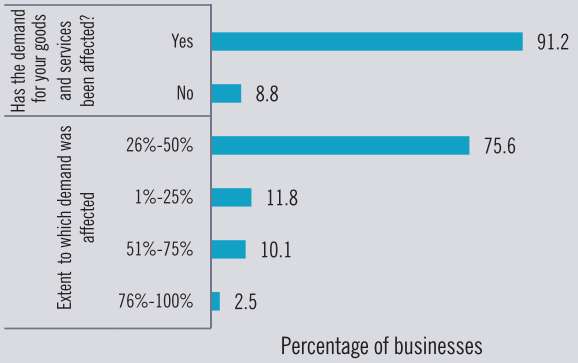
Question of the quarter

Effect of price increment on demand for goods and services

In this quarter, we sought to understand the effect of the recent general price hikes on the demand for goods and services and the extent to which demand has been affected.

In particular, we asked: a) "Has the demand for your goods and services been affected by the recent general price hikes?" b) "If yes, by what percentage?"

Figure 5 Extent to which price increments have affected demand for goods and services



Results (Figure 5) indicate that most businesses in our sample (91.2 percent) faced a decline in the demand for their goods and services because of the recent price hikes. Among the affected firms, the majority (75.6 percent) reported a decline in demand between 26 percent and 50 percent. This was followed by 11.8 percent of firms that reported a decline in demand of less than 26 percent and 10.1 percent of firms that reported a decrease in demand for the goods and services between 51 percent and 75 percent, respectively.

A decline in demand for goods and services is a disincentive for production and lowers the business sales and revenue. This is because the excess supply forces businesses to lower their prices to sell, forcing some businesses out of the market. Therefore, demand-driven policy interventions are necessary to match the supply and encourage continuous production.

Conclusion

Perceptions about doing business in Uganda in the current quarter (January-March 2022) slightly declined compared to the previous quarter (October-December 2022). The decline was due to the deterioration of all sub-indices. Just like in the last quarter, some business constraints persisted. In this regard, tax policy, macroeconomic factors and insufficient demand were critical binding constraints to business competitiveness in the current quarter (January-March 2022). Considering future expectations, business sentiments for the next quarter (April-June 2022) are expected to improve across all sectors. The next quarter will see below-potential sentiments for the agriculture sector and above full potential in the manufacturing and services sector. Generally, the expected improvement in the business environment is linked to expected improvement in capital utilisation, reduced input and product costs, increased optimism and a better business environment. Considering the effect of price hikes on demand for goods and services, most of the businesses suffered a decline in the demand for their goods and services because of the price hikes during the quarter under review. There is a need for demand-driven policies to encourage continuous production and counter the adverse effects of price hikes.

Endnotes

1 https://eprcug.org/publication/drivers-of-changes-in-ugandas-fuel-pump-prices-during-the-covid-19-crisis/
2 https://www.ubos.org/wp-content/uploads/publications/02_2022CPI_Press_Release_February_2022.pdf
3 https://www.ubos.org/wp-content/uploads/publications/04_2022CPI_PUBLICATION_FOR_MARCH_2022.pdf
4 https://www.bou.or.ug/bou/bouwebsite/Statistics/Statistics.html
5 https://www.era.go.ug/index.php/media-centre/what-s-new
6 https://www.bou.or.ug/bou/bouwebsite/Statistics/Statistics.html

The Economic Policy Research Centre (EPRC) has been producing the Business Climate Index (BCI) for Uganda since June 2012. The BCI reflects the perceptions of Ugandan business managers on the current and near-future (expected three months ahead) business conditions. The BCI is a perceptions indicator of economic activity and the general business environment in which businesses operate. The purpose of BCI is to forecast turning points in economic activity and thus provide critical information for policy makers both in Government and the Private Sector.

About EPRC
The Economic Policy Research Centre (EPRC) is an autonomous not-for-profit organization established in 1993 with a mission to foster sustainable growth and development in Uganda through advancement of research – based knowledge and policy analysis.

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